
Confidence, credibility and macroeconomic policy

Past, present, future

Richard C.K. Burdekin and
Farrokh K. Langdana



London and New York

Contents

List of figures	x
List of tables	xi
Foreword by the Honourable Ruth Richardson MP	xiii
Acknowledgements	xvii
Introduction	xix

Part I Credibility in practice and in experimental testing

1 Fiscal policy, credibility and inflation: The critical role of confidence factors	3
<i>Introduction and overview</i>	3
<i>Theoretical perspectives on deficit finance</i>	9
<i>Does fiscal stringency always eliminate inflation?</i>	13
<i>Establishing credibility for the disinflation process</i>	20
<i>Conclusions and implications</i>	26
2 Bond-financed deficits, taxation and expectations: An experimental test of the Ricardian equivalence theorem	28
<i>Model description</i>	31
<i>Experiment design</i>	33
<i>Results</i>	36
<i>Conclusions</i>	42
<i>Appendix: An experimental examination of interest-rate effects of fiscal policy</i>	43
3 Monetary credibility and national output: An experimental verification of the Lucas 'islands' explanation of business cycles	45
<i>An adaptation of the Lucas 'islands' model</i>	47

<i>Experiment description and results</i>	49
<i>Conclusions</i>	53
<i>Appendix: Instructions to participants</i>	54
Part II Confidence and credibility factors in historical perspective	
4 Public confidence and public finance during the American Civil War: Lessons from North and South	59
<i>Introduction</i>	59
<i>Trends in money supply and money demand during the Civil War</i>	62
<i>The setting for fiscal policy</i>	69
<i>Problems with bond financing</i>	75
<i>Northern resurgence and Confederate financial collapse</i>	79
<i>Conclusions</i>	82
<i>Appendix</i>	83
5 Deficit finance, expectations and real money balances: The operation of the inflation tax in Germany after the First World War	90
<i>Introduction</i>	90
<i>Real money balances and the inflation tax</i>	95
<i>Empirical results</i>	98
<i>Discussion and further analysis</i>	105
<i>Conclusions</i>	106
<i>Appendix</i>	108
6 Does exchange rate pegging foster monetary credibility? The European Monetary System and the 1980s disinflation	110
<i>Introduction</i>	110
<i>Method of analysis</i>	113
<i>Assessing whether EMS membership made a difference</i>	119
<i>Testing for shifts in the Phillips curve</i>	125
<i>Conclusions</i>	127
<i>Appendix: Description of the international data</i>	128

Part III Consumer confidence and macroeconomic stabilisation in the 1990s

7	Consumer confidence in today's macroeconomy:	
	Definition, measurement and potential importance	139
	<i>Consumer confidence indexes: definitions and measurement</i>	142
	<i>Theories of the major role of consumer confidence: a review</i>	144
8	Consumer confidence and the optimal timing of effective monetary stabilisation	
	<i>(with Giles Mellon)</i>	148
	<i>Model</i>	150
	<i>Solution technique and results</i>	152
	<i>Appendix A</i>	156
	<i>Appendix B</i>	157
9	Consumer confidence and domestic fiscal stabilisation	
	<i>(with Giles Mellon)</i>	158
	<i>Model</i>	162
	<i>Solution technique and results</i>	164
	<i>Summary and conclusion</i>	168
	<i>Appendix A</i>	168
	<i>Appendix B</i>	169
	<i>Appendix C</i>	169
	<i>Appendix D</i>	169
	Notes	170
	Bibliography	187
	Index	201